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Federal Estate Tax -- "Incidents of Ownership" in Group Life Insurance, A Phrase Searching for Definition

Steven Kropelnicki Jr.

Policy Act[87] can regulate activities that are perhaps beyond NEPA's reach. Notice of such state regulation has already been taken by the Fourth Circuit.[88] The plaintiffs in *Rucker* could have resorted to these state laws to enjoin the "leveling of the dunes" and the grant of the state dredge and fill permit. With responsible local action, the state EPA could have been enacted to force the compilation of an impact statement for the *Rucker* project.[89]

The maturation and future vitality of NEPA may be endangered by irritating retrogressions caused by unsuccessful attempts to apply it in areas where it perhaps should not be used at all. Only in developing and using the supplements and alternatives to NEPA, which already exist in many states, can a truly comprehensive and unified body of environmental law—both state and federal—mature and gain strength. By realizing that NEPA need not be alone, future *Ruckers* may be prevented, and judicial determinations of whether NEPA does or does not apply can be rendered less critical in many upcoming environmental disputes.

WILLIAM P. FARTHING, JR.

Federal Estate Tax—"Incidents of Ownership" in Group Life Insurance, A Phrase Searching for Definition

Under section 2042(2) of the Internal Revenue Code of 1954 insurance on the life of a decedent is taxable to the extent that he possessed, at the time of his death, any "incidents of ownership" in the

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dredge and fill statute, allows "any property owner whose property may be damaged" by the granting of a dunes permit a right of appeal to the Board of County Commissioners. Under section 104B-10, the Commissioners' action is "subject to review by the superior court of the county by proceedings in the nature of certiorari." The dunes legislation is intended to prevent any damage that "will not materially weaken the dune or reduce its effectiveness as a means of protection from the effects of high wind and water. . . ." *Id.* § 104B-5. The fact that defendant Willis was able to completely level his dunes bespeaks the weakness of the dunes statute. The statute is in line for a substantial strengthening by the North Carolina General Assembly, however.

87. N.C. GEN. STAT. §§ 113A-1 to -10 (Supp. 1973).

88. Civic Improvement Comm. v. Volpe, 459 F.2d 957, 958 (4th Cir. 1972) (per curiam).

89. *See* N.C. GEN. STAT. §§ 113A-8, -9 (Supp. 1973). By vote of the local governing body, the "action forcing" requirements of the state EPA, *id.* § 113A-4(2) (Supp. 1973), can be applied to local projects that are greater than two contiguous acres in extent.

policy.[1] Since the Code nowhere defines the phrase "incidents of ownership," the courts have been in the process of determining its meaning since it was first used in the 1929 revision of the Regulations under the 1918 Code.[2] Recently the Court of Appeals for the Fifth Circuit, in *Estate of Lumpkin v. Commissioner*,[3] gave the term what may be its broadest meaning. The court held that the mere power to alter the time and manner of enjoyment of the proceeds by the beneficiaries was sufficient to constitute an incident of ownership. While the result of the decision may not be far-reaching, both the court's conclusion and method of analysis seem to be logically inconsistent with other recent decisions which have focused on the meaning of "incidents of ownership."

At the time of his death James H. Lumpkin, Jr. was covered by a non-contributory group term life insurance policy issued to his employer. The terms of the policy provided for the payment of a lump sum of two hundred dollars immediately upon the employee's death plus a series of monthly payments, in an amount equal to one half of the employee's normal monthly compensation, to continue for a period determined by the length of the employee's service with the employer.[4] The beneficiaries of the policy were irrevocably fixed and were of three classes. The wife of the employee, if living at the time of his death, would receive the payments until they were exhausted or until her death. If there were no surviving spouse, payments went to the next of the classes,[5] who, like the spouse, would receive them until their exhaustion or the death of the beneficiary. If all beneficiaries in a class died before the payments were exhausted, the remaining payments did not accrue to the estate of any beneficiary but rather were paid to members of the next class. Because there were only three classes of beneficiaries and because payments terminated on the death of the last of these, there was no assurance that any or all of the amount of the proceeds would be paid by the insurer, and in no case would the proceeds ever be payable to the estate of the insured.

1. INT. REV. CODE OF 1954, § 2042(2) provides, in pertinent part:
The value of the gross estate shall include the value of all property—
(2) Receivable by other beneficiaries.—To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any incidents of ownership . . . .
2. Treas. Reg. 70, Art. 27 (1929).
3. 474 F.2d 1092 (5th Cir. 1973).
4. *Id.* at 1094 n.5.
5. The next two classes were children of the insured, under twenty-one years

The insured possessed one substantive power over the proceeds of the policy—he could elect an optional mode of payment to his spouse. This option would reduce the amount of each monthly payment and lengthen the period of time over which the payments would be made.[6] For example, he could elect to have the payments reduced by one half and paid for twice as long. In any case the total amount paid to the spouse would remain the same. In the event that the insured elected this mode of settlement and the spouse died before the payments were exhausted, the estate of the spouse would receive the difference between the amount actually received and the amount which would have been paid during that time at the higher rate of payment had the option not been elected. Therefore, Lumpkin possessed only the power to change the time at which the proceeds would be enjoyed; he could not change the amount that any beneficiary (or the estate of that beneficiary) would receive, nor could he exercise any power for his own economic benefit.

The Tax Court held that the very limited power possessed by Lumpkin was not a power to dispose of the property and was not an appropriate subject of the estate tax.[7] The court relied upon the language of Treasury Regulations section 20.2042-1(c)(2) and a 1937 case, *May Billings*,[8] which had held that options as to the modes of settlement that were much broader than were involved in *Lumpkin* did not amount to a "control of the proceeds" and therefore did not result in inclusion.[9]

The court of appeals reversed. Noting that the Code does not define the term "incidents of ownership," the court examined the congressional committee reports[10] that accompanied the enactment of the first predecessor to section 2042.[11] The reports listed illustrative kinds of rights comprehended by the phrase: "the right of the insured to the economic benefits of the policy, the right to change beneficiaries, the right to surrender or cancel the policy, the right to assign the policy, the right to pledge the policy for a loan, and others."[12] The court inferred

of age or permanently incapable of self-support, and parents of the insured. *Id.* at 1093.

6. *Id.* at 1094 n.5.

7. Estate of James H. Lumpkin, Jr., 56 T.C. 815, 824 (1971).

8. 35 B.T.A. 1147 (1937).

9. *Id.* at 1152.

10. H.R. REP. No. 2333, 77th Cong., 2d Sess. 163 (1942); S. REP. No. 1631, 77th Cong., 2d Sess. 235 (1942).

11. Revenue Act of 1942, ch. 619, § 404, 56 Stat. 798, *amending* Int. Rev. Code of 1939, ch. 3, § 811(g), 53 Stat. 122.

12. 474 F.2d at 1095, referring to authorities cited note 10 *supra*.

from this list that Congress intended to tax the value of life insurance proceeds over which the insured at the time of his death still possessed a "substantial degree of control."[13] The inference was strengthened in the eyes of the court by recognition of the congressional intent to give life insurance policies estate tax treatment roughly equivalent to that afforded other types of property under related sections of the Code.[14]

The Commissioner relied upon two relatively more recent cases to offset the impact of *Billings.* The first of these, *Lober v. United States*,[15] held that the forerunner to section 2038[16] required inclusion of the value of the trusts in gross estate where the decedent had created several irrevocable trusts for the benefit of his children but had retained, as trustee, a power to accelerate the remainder. In *Lober* the taxpayer argued that because under state law the beneficiaries had a vested interest in the trust proceeds the power retained by the decedent was not a power to "alter, amend or revoke," but the Supreme Court concluded that the beneficiaries were granted no present right to immediate enjoyment of the trust property and that the degree of control retained by Lober was sufficient to result in inclusion.

In *United States v. O'Malley*[17] the decedent had created several irrevocable trusts for the benefit of members of his family. As one of the trustees, he retained the power to pay the trust income to the beneficiaries or to accumulate it and add it to the principal, in which case the beneficiaries' enjoyment of the income could be postponed and be conditioned upon their surviving the termination of the trusts. The Supreme Court held that this power to alter the time and manner of enjoyment was significant and sufficient to invoke the predecessor to section 2036.[18]

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13. 474 F.2d at 1095.

14. *See* INT. REV. CODE OF 1954, §§ 2036 (transfers with retained life estate), 2037 (transfers taking effect at death), 2038 (revocable transfers), 2041 (powers of appointment).

The only authority cited for this proposition is Estate of Skifter v. Commissioner, 468 F.2d 699 (2d Cir. 1972), discussed at text accompanying notes 34-46 *infra.*

15. 346 U.S. 335 (1953).

16. Int. Rev. Code of 1939, ch. 3, § 811(d)(2), 53 Stat. 122 [hereinafter cited as Int. Rev. Code of 1939].

17. 383 U.S. 627 (1966).

18. Int. Rev. Code of 1939, § 811(c)(1)(B)(ii). Actually the *O'Malley* case dealt specifically with the issue of whether the decedent had ever "transferred" the trust income. The proposition for which the case was cited in *Lumpkin* was deemed by the *O'Malley* court to have been decided in Commissioner v. Estate of Holmes, 326 U.S. 480 (1946), and nothing in the *O'Malley* decision added to or detracted from the proposition adopted in *Holmes* that the type of power held by the decedent

Based on these cases, the *Lumpkin* court concluded that the power to alter the time and manner of enjoyment gives its holder a substantial degree of control, at least for purposes of sections 2036 and 2038. In view of the congressional intent to make the estate tax treatment of life insurance proceeds similar to that of other types of property, the court felt it would be anomalous to hold that such a power is not also an incident of ownership within the meaning of section 2042. In the view of the *Lumpkin* court, the only significant distinction between sections 2036 and 2038, on the one hand, and section 2042, on the other, is that the former require an incomplete transfer while under the later a transfer is unnecessary. Thus sections 2036 and 2038 deal with powers *retained*[19] by the decedent over property that he initially transferred, while under section 2042 the decedent at death need merely *possess* an incident of ownership. The means by which he came into possession was considered irrelevant.[20] *Lumpkin* found that this distinction does not imply any further differences among the sections as to the degree of power the decedent must hold over the property in order to render its value includible in his gross estate. Accordingly, the court held that Lumpkin possessed an "incident of ownership" in the insurance policy.

The court concluded by stating that Lumpkin could have assigned the right to select the optional modes of settlement, divesting himself of the power and thereby avoiding the estate tax on the proceeds.

Arguably, *Lumpkin* will have little practical effect upon those who are covered by group term life insurance policies. A recent comment[21] points out that it should be relatively simple for employers who are concerned with the estate tax consequences of the decision to re-write the insurance policies so as to require their employees to make an irrevocable designation of the mode of settlement and thereby divest the insured of the power. However, the court's suggestion that the employee

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in that case was significant. Indeed the *Lumpkin* court's reliance on *O'Malley* in this context is completely misleading. It is arguable that *Lober,* which also relied strongly upon *Holmes,* added nothing to the law in this regard and that the mere ability to determine the time and manner of enjoyment of transferred property had been held to be sufficient to result in inclusion in the gross estate of the transferee as early as 1946. The significance of this possibility is discussed at text accompanying note 54 *infra.*

19. This interpretation of section 2038 is not consistent with the literal wording of that provision, but does appear to be consistent with the interpretation given the section by the Second Circuit in *Skifter,* discussed at text accompanying notes 34-46 *infra.*

20. 474 F.2d at 1097.

21. 10 HOUSTON L. REV. 984, 986 (1973).

assign the right to select the optional modes of settlement is potentially dangerous. The cases clearly indicate that if such an assignment is made solely for the purpose of avoiding the estate tax and the insured dies within three years of the assignment, section 2035 (transfers made in contemplation of death) will operate to include the value of the proceeds.[22]

The estate tax treatment of life insurance on the life of the decedent payable to other beneficiaries has had a varied history.[23] Life insurance is one of the only forms of property given special treatment in a separate Code section and when section 2042(2) is compared to related sections of the Code it is apparent that life insurance is treated very differently from other property.[24] Some commentators view the IRS attitude toward life insurance as unfavorable;[25] it certainly appears that the Service has been attempting to push the definition of "incidents of ownership" to the outer limits in recent cases.[26] The broad interpretation given to the phrase by the *Lumpkin* court, therefore, will be important in two respects. Those who favor a more lenient estate tax treatment of life insurance will see it as potentially dangerous precedent and those who take the opposite view will be concerned that the

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22. *See, e.g.*, Slifka v. Johnson, 161 F.2d 467 (2d Cir. 1947); Vanderlip v. Commissioner, 155 F.2d 152 (2d Cir. 1946); First Trust & Deposit Co. v. Shaughnessy, 134 F.2d 940 (2d Cir. 1943).

23. *See generally* C. LOWNDES & R. KRAMER, FEDERAL ESTATE & GIFT TAXES ch. 13 (1962); 2 J. MERTENS, THE LAW OF FEDERAL GIFT AND ESTATE TAXATION § 17 (1959). Courts have held the following powers to be incidents of ownership: the power to change the beneficiary or assign the policy, Commissioner v. Noel, 380 U.S. 678 (1965); the power to surrender or cancel the policy, Commissioner v. Treganowan, 183 F.2d 288 (2d Cir.), *cert. denied*, 340 U.S. 853 (1950); the power to borrow against the policy from the insurer, Fried v. Granger, 105 F. Supp. 564 (W.D. Pa. 1952), *aff'd*, 202 F.2d 150 (3rd Cir. 1953). However, it has been held that the power to terminate group life insurance solely by terminating employment is not an incident of ownership; *see* Landorf v. United States, 408 F.2d 461 (Ct. Cl. 1969); Estate of James H. Lumpkin, Jr., 56 T.C. 815 (1971); Rev. Rul. 72-307, 1972-1 CUM. BULL. 307.

24. *See* Lowndes, *An Introduction to The Federal Estate and Gift Taxes*, 44 N.C.L. REV. 1, 13 (1965).

25. Wilson, *Equal Treatment for Life Insurance*, 112 TRUSTS & ESTATES 270 (1973).

26. In Estate of James H. Lumpkin, Jr., 56 T.C. 815 (1971), the Commissioner argued that not only the power to select the optional mode of settlement but also the power to cancel the insurance by terminating employment, the power to convert the policy upon termination of employment, and the power to assign all rights under the policy were incidents of ownership. The court rejected all of these arguments and they were not pursued on appeal. In Landorf v. United States, 408 F.2d 461 (Ct. Cl. 1969), the Commissioner had also been unsuccessful in these arguments. Rev. Rul. 72-307, 1972-1 CUM. BULL. 307, reflects the acceptance by the I.R.S. of the proposition that the power to cancel group term life insurance by terminating employment is not an incident of ownership.

decision does not deal with some of the arguments which will be raised, as they have been in prior cases, to support a more limited definition of "incidents of ownership."

Two other recent cases which have focused on the meaning of the term "incidents of ownership" illustrate a different approach from that taken by the court in *Lumpkin* and reach a result which seems to be logically inconsistent with it. In *Estate of Fruehauf v. Commissioner*[27] the wife of the decedent had owned certain insurance policies on her husband's life. However, she predeceased him by fourteen months, leaving a will that established a trust to which the life insurance policies passed. As co-executor of the wife's estate and co-trustee of the trust, Fruehauf had powers in a fiduciary capacity over the insurance policies which would clearly have been incidents of ownership under other circumstances. The Tax Court held that the proceeds were includable in Fruehauf's gross estate.[28] It rejected the contention that the capacity in which the powers are held should be significant in determining whether they were sufficient to constitute incidents of ownership.[29]

The Sixth Circuit affirmed, but the court rejected what it termed a "broad *per se* rule" that possession of powers sufficient to constitute incidents of ownership would always result in the inclusion of the proceeds of policies, regardless of the fact that the powers were held in a fiduciary capacity.[30] The court focused on the fact that where the decedent was a transferee of the powers but could not exercise them for his own economic benefit, such an arrangement can hardly be construed as a substitute for testamentary disposition on the decedent's part.[31] The court then stated that the Tax Court had ignored the fundamental nature of the fiduciary relationship, citing previous cases which had recognized that the capacity in which incidents were held was important.[32] The Sixth Circuit concluded that since the decedent was the lifetime beneficiary of the testamentary trust established by his wife, he had the ability to exercise the powers in such a way as to give himself the economic benefit of the life insurance. It was this dual

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27. 427 F.2d 80 (6th Cir. 1970).
28. Estate of Harry R. Fruehauf, 50 T.C. 915 (1968).
29. *Id.* at 926.
30. 427 F.2d at 83-84.
31. *Id.* at 84; *cf.* Porter v. Commissioner, 288 U.S. 436, 444 (1933); Commissioner v. Chase Nat'l Bank, 82 F.2d 157, 158 (2d Cir. 1936).
32. Estate of Bert L. Fuchs, 47 T.C. 199 (1966); Estate of Newcomb Carlton, 34 T.C. 988 (1960), *rev'd on other grounds*, 298 F.2d 415 (2d Cir. 1962).

position as fiduciary and beneficiary under the will and trust instrument that gave Fruehauf incidents of ownership in the policies and required inclusion of their proceeds in his gross estate.[33]

Estate of Skifter v. Commissioner[34] dealt with a similar situation. Here the decedent had owned the insurance policies but more than three years before his death he had divested himself of all interest in and power over them by assigning them to his wife. As in *Fruehauf*, the wife had pre-deceased the insured and had left a will which set up a trust containing the policies and naming the insured as trustee. Skifter's powers as trustee were not so broad as those of Fruehauf since Skifter could not exercise any power for his own economic benefit. Nevertheless, the Commissioner argued that the decedent possessed incidents of ownership in the policies and that they should be included in his gross estate under section 2042(2). The *Skifter* court cited the same list of examples of incidents of ownership which the *Lumpkin* court had examined,[35] but in *Skifter* the court also noted the language of Treasury Regulations section 20.2042-1(c)(2) which read in part:

> Generally speaking, the term [incidents of ownership] has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer à loan against the surrender value of the policy . . . .[36]

This language is almost identical to that found in the congressional committee reports, but there is an important distinction. The committee reports merely include the right to economic benefit from the policy as one example of powers and rights which might constitute incidents of ownership, whereas the regulations state that an incident of ownership has reference to the right to economic benefit and thus includes several other rights and powers the possession of which arguably constitutes a right to economic benefit.[37] The court obviously

33. 427 F.2d at 86.
34. 468 F.2d 699 (2d Cir. 1972).
35. *See* note 12 and accompanying text *supra*.
36. Treas. Reg. § 20.2042-1(c)(2) (1958).
37. Clearly the power to pledge the policy for a loan or to obtain a loan from the insurer against the surrender value of the policy involves a right to economic benefits from the policy. Whether the other rights and powers mentioned involve economic benefits will depend upon the nature of the insurance and the terms of the policy, *e.g.*, unless the power to change the beneficiary is restricted it includes the power to designate the estate of the insured as beneficiary, and this may be an economic interest. Similarly, the power to assign the policy may be a right to eco-

focused upon the wording of the regulations because it found significant the fact that Skifter could not have exercised any of his powers for his own economic benefit.[38]

The predecessor to section 2042 provided that even if the decedent divested himself of all interest in an insurance policy on his life, the proceeds would still be included in his gross estate if he had continued to pay the premiums on the policy.[39] This provision was dropped from the Code in 1954, and in the congressional comittee reports[40] accompanying the enactment of section 2042 the *Skifter* court found language which indicated that in dropping the "payment of premiums" test Congress intended to give life insurance treatment more nearly equal to that afforded other types of property under the estate tax.[41] While recognizing that this legislative history was hardly conclusive, the court felt that it gave support to the argument that in defining "incidents of ownership" the courts should examine the treatment given other property under sections 2036, 2037, and 2038.

Treasury Regulation section 20.2042(c)(4) provides, in part

> A decedent is considered to have an "incident of ownership" in an insurance policy on his life held in trust if, under the terms of the policy [he] . . . has the power [as trustee or otherwise] to change the beneficial ownership in the policy or its proceeds, or

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nomic benefit if the nature of the policy is such that an assignment would have any value. It is difficult to determine what significance should be attached to this difference in wording between the committee reports and the Treasury Regulations. *See* Note, *Estate Taxation of Life Insurance Policies Held by the Insured as Trustee,* 32 MD. L. REV. 305, 310 n.23 (1972).

38. 468 F.2d at 702. There is support in the cases for the proposition that incidents of ownership refer to a right to economic benefits from the policy; *see, e.g.,* Chase Nat'l Bank v. United States, 278 U.S. 327 (1929); Prichard v. United States, 397 F.2d 60 (5th Cir. 1960); Commissioner v. Chase Manhattan Bank, 259 F.2d 231 (5th Cir. 1958). *But see* United States v. Rhode Island Hosp. Trust Co., 355 F.2d 7, 11 (1st Cir. 1966), discussed in note 50 *infra.*

39. Revenue Act of 1942, ch. 619, § 404, 56 Stat. 798.

40. The committee stated that the "payment of premiums" test was dropped because no other type of property was subject to the estate tax where the decedent purchased it but gave it away long before his death "and because to discriminate against life insurance in this regard is not justified." The 1954 Code also incorporated into section 2042(2) the section 2037 rule that a reversionary interest in the property qualifies for inclusion if the value of the interest exceeds five per cent of the value of the property; this was done to place "life insurance policies in an analogous position to other property . . . ." S. REP. No., 1622, 83d Cong., 2d Sess. 124 (1954).

41. 468 F.2d at 702. The court found additional support for the proposition that life insurance was intended to receive treatment similar to that afforded other types of property in the fact that the interests and powers which Congress included as examples of incidents of ownership were similar to those which would result in inclusion of other property under other sections of the Code.

the time or manner of enjoyment thereof, even though the decedent has no beneficial interest in the trust.[42]

The *Skifter* court agreed with the Tax Court[43] that if this section were given its broadest reading it would conflict with Regulation section 20.2042(c)(2), but it rejected a broad reading where the decedent had possessed no power to benefit himself or his estate.[44]

Although the Second Circuit agreed that section 2042 should be read in light of related sections of the Code and recognized that the literal language of section 2038 provides that the section will result in taxation "without regard to when or from what source the decedent acquired" the power, it pointed out that the legislative history of that language indicated it was intended to apply only to the situation where the decedent himself created a power in someone else at the time of transfer and which later devolved upon him before his death.[45]

The court concluded that because none of the other code sections would have taxed the policies had they been other property and because Congress did not intend to discriminate between life insurance and other forms of property the powers possessed by Skifter at his death did not constitute incidents of ownership.[46]

There is apparent disparity between the holdings in *Lumpkin* on the one hand and *Fruehauf* and *Skifter* on the other. The disparity might best be characterized in terms of the dichotomy between the inference in *Lumpkin* that any significant power over the proceeds of an insurance policy alone constitutes an incident of ownership and the implicit recognition in *Fruehauf* and *Skifter* that there is a further test which must be applied—that certain powers are not within the purview

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42. Treas. Reg. § 20.2042(c)(4) (1958).

43. Estate of Hector R. Skifter, 56 T.C. 1190, 1198 (1971).

44. 468 F.2d at 703. There appear to be three alternative ways in which Treas. Reg. § 20.2042-1(c)(4) may be reconcilable with § 20.2042-1(c)(2). First, the language of (c)(2) which reads "generally speaking . . . economic benefits" does not preclude the possibility of non-beneficial interests. Second, (c)(4) may be read as applying only to the situation where the decedent retains powers over policies transferred in trust. Third, since (c)(4) is the only section of the regulations which speaks of policies *held* in trust the section may apply only to a policy which is placed in trust regardless of whether the insured retained the power or himself made the transfer to the trust. The *Skifter* courts considered only the first and second possible constructions—the third alternative, if accepted, would have governed in *Skifter*. This analysis of Treas. Reg. § 20.2042(c)(4) is found in an excellent criticism of the opinion of the *Skifter* court: Note, 32 MD. L. REV., *supra* note 37, at 309.

45. 468 F.2d at 705. This interpretation of section 2038 is subject to criticism, *see* Note, 32 MD. L. REV., *supra* note 37, at 313-18. The *Lumpkin* court, however, seems to have accepted this interpretation, *see* note 14 *supra*.

46. 468 F.2d at 705.

of the "incidents of ownership" test, even though they may give the insured very real control over the policy or its proceeds.

One aspect of the latter viewpoint would certainly be the focus of the Tax Court in *Lumpkin* on the *de minimis* nature of the right held by the decedent. There are some powers which the insured may possess which give him such a small degree of control that they have been held to be insufficient to constitute incidents of ownership even though they are certainly property rights in the broad meaning of the term.[47]

Another aspect of this test involves the recognition that the source of the power in question is significant. If the reasoning of *Fruehauf* and *Skifter* is accepted it might well be concluded that Lumpkin was as much the transferee of the power which he held as were the decedents in those two cases. The language of section 2042(2) provides that taxation will result where the decedent "possessed" an incident of ownership, but this language did not preclude the *Fruehauf* or *Skifter* court's examination of the source of the power.

Perhaps more important is the *Lumpkin* court's failure to deal convincingly with the argument that an incident of ownership refers to a right to economic benefits from the insurance. As attorneys for the taxpayer argued in their brief,[48] there is a long line of cases equating incidents of ownership with beneficial interest.[49] This was certainly important in both *Fruehauf* and *Skifter*, and might well be one line of demarcation in a proper definition of "incidents of ownership." Because the *Lumpkin* decision departs from this trend, the court would have done well to treat the issue directly, and they would have found some support in a few cases which have rejected the argument that lack of beneficial interest will always prevent a power from being an incident of ownership.[50]

47. *See* note 26 *supra*.

48. Brief for Appellee at 11, Estate of Lumpkin v. Commissioner, 474 F.2d 1092 (5th Cir. 1973).

49. *See* cases cited note 38 *supra*.

50. *See* United States v. Rhode Island Hosp. Trust Co., 355 F.2d 7, 11 (1st Cir. 1966). This case was mentioned in the opinion of the Tax Court in *Skifter* but was found to deal with an entirely different kind of situation and to offer only superficial support to the contention of the government that an incident of ownership need not give the insured the right to economic benefits from the policy. 56 T.C. at 1198 n.2.

The court might also have examined Treas. Reg. § 20.2042-1(c)(4) in light of the analysis contained in note 44 *supra*. If the court had accepted the first alternative discussed there and used that interpretation of the Regulation to bolster its rejection of the contention that an incident of ownership always refers to a beneficial interest, Neither the *Skifter* nor *Lumpkin* courts found conclusive support for the proposition that Congress intended, in enacting the 1954 Code, to give life insurance more nearly equal treatment to that afforded other types of property. As mentioned previously, the only support which the court in *Skifter* found for this proposition was the language of the congressional committee reports dealing with the dropping of the payment of premiums test,[51] and the *Lumpkin* opinion cites only *Skifter* as authority. As a general proposition, the validity of the inference by the *Skifter* court from the language of the reports may have some merit,[52] but in the context of *Lumpkin* it is open to serious question. The *Billings* decision had been acquiesced in by the Commissioner in 1937,[53] and this acquiescence was outstanding at the time of the *Lumpkin* decision. The *Lober* case cited by the *Lumpkin* court was handed down in 1953, and the proposition for which *O'Malley* was cited in *Lumpkin* had actually been decided in 1946.[54] Since the Supreme Court had determined *before* the enactment of the 1954 Code that the mere power to alter the time and manner of enjoyment of transferred property was sufficient to result in inclusion under the forerunners to sections 2036 and 2038, it might be argued that had Congress intended to apply the same test to incidents of ownership, it would have done so directly rather than in the vague wording in a congressional committee report, and that since it had not done so the *Billings* decision should stand.

However, assuming that Congress did intend to make the estate tax treatment of life insurance more nearly parallel to that given other types of property under related sections of the Code, the *Lumpkin* decision may be subject to even more criticism. The entire scheme of the federal estate tax rests upon the basis of a tax on the privilege of transferring property at death coupled with "taxes upon other types of transfers that have some of the aspects of a testamentary transfer and would otherwise be resorted to in order to escape a tax limited to strictly testamentary transfers."[55] Thus in interpreting section 2042 and related sections of the Code the courts should consider whether the

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this argument, coupled with the language from the *Rhode Island Hosp. Trust Co.* opinion would have been a much more persuasive method of dealing with a concept on which has been founded the rejection of many of the Government's attempts to include non-beneficial powers as incidents of ownership.

51. Note 40 *supra.*

52. *See* Note, 32 MD. L. REV., *supra* note 37, at 306 n.25.

53. 1937-2 CUM. BULL. 3, *withdrawn,* 1972-2 CUM. BULL. 3.

54. Note 18 *supra.*

55. Lowndes, *supra* note 24, at 4.

transfer or power at issue appears to be a "substitute for testamentary disposition of property."[56]

An examination of the Code will reveal that with the exception of sections 2040, 2041 and 2042, all of the sections require that the decedent have made an incomplete transfer of the property, which necessarily implies that he have had beneficial interest in it. Section 2040 taxes jointly held property to the extent that the consideration for it was furnished by the decedent, and thus reaches a situation where the decedent transferred property which he owned in exchange for property which is held jointly. Section 2041 taxes property over which the decedent had a general power of appointment—a power exercisable for the benefit of himself or his estate. It is thus apparent that section 2042 is the only section which can be read to reach property which the decedent neither owned nor had any beneficial interest in and over which he never had any power exercisable for his own benefit or that of his estate.[57] Since Congress has rejected the contention that life insurance is inherently testamentary,[58] it seems only logical that if Congress did intend to remove the discriminatory aspects of life insurance taxation under the Code, it intended that an incident of ownership be equated with the right to economic benefits of the policy. If this interpretation is given to the phrase, an incident of ownership may be seen as similar to an incomplete transfer of the property (in the situation where the insured has beneficial interest in the property but transfers it, retaining a life estate, power to revoke, etc.) or a general power of appointment (where the decedent never owned the policy but was given a power exercisable for the benefit of himself or his estate).

By equating the nature of the power required under sections 2036 and 2038 with that required by section 2042 but ignoring the distinctions between the types of property involved, the *Lumpkin* court reached a decision which is clearly contrary to what the court itself saw as congressional intent. The court also failed to read correctly the focus of the *Skifter* opinion which it cited as authority for this view of

56. *See* Porter v. Commissioner, 288 U.S. 436, 444 (1933); Commissioner v. Chase Nat'l Bank, 82 F.2d 157, 158 (2d Cir. 1936); H.R. REV. No. 767, 65th Cong., 2d Sess. 22 (1919).

57. Certainly the insured may have possessed a beneficial interest in a life insurance policy, and in the case where he purchases the policy himself and later transfers it, it is difficult to distinguish this form of property from any other with respect to its treatment under the estate tax. Only in the case of an insured who did not himself purchase the insurance, such as in the group life insurance situation, is the *Lumpkin* court's result obviously discriminatory toward life insurance.

58. H.R. REP. No. 1337, 83rd Cong., 2d Sess. A316-17, B14-15 (1954).

congressional intent, for *Skifter* had asked whether the property would be taxed under other sections of the code if it were not life insurance, not whether the power held by the decedent would have been sufficient under those sections to result in inclusion. This distinction is critical, for the former statement of the issues requires the court to examine, in addition to the nature of the power, the source of the power, the way in which it is held, and whether the arrangement is a substitute for testamentary disposition of the property.

Implicit in the *Lumpkin* court's decision is the view that even though life insurance is not always inherently testamentary, it has testamentary characteristics which may justify taxation in situations where other forms of property would not be taxed. Whether this premise is valid is open to question in view of the refusal of Congress to treat life insurance as inherently testamentary, but even if the premise is accepted the court did little to provide guidelines for applying it to other situations. The factors which other courts have viewed as important in defining "incidents of ownership" are neither integrated into the *Lumpkin* result nor rejected outright; this should allow wide latitude for other courts to distinguish the decision.

Lumpkin is an apparent success for the contention of the Service that powers sufficient to result in inclusion under other sections of the Code are sufficient to constitute incidents of ownership, but it does little to provide a workable definition of "incidents of ownership" and may only inject more confusion into this unsettled area of the law.

STEVEN KROPELNICKI, JR.

Federal Income Tax—Internal Revenue Code Sections 167 and 263—Depreciation on Depreciation?

Section 167 of the Internal Revenue Code allows the taxpayer a deduction from gross income for depreciation of certain property used in his business.[1] Section 263 forbids the deduction of any amounts

1. INT. REV. CODE OF 1954, § 167, provides in part:

(a) General Rule.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

Prior versions of section 167, applicable to cases discussed in the text, are comparable.